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No. 82-327

In the Supreme Court of the United States

OCTOBER TERM, 1982

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

and

THE OPTIONS CLEARING CORPORATION,
Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Petitioners, Chicago Board Options Exchange, Incorporated ("CBOE") and The Options Clearing Corporation ("OCC"),[1] submit this reply in response to certain new arguments raised by the respondent, Board of Trade of the City of Chicago ("Board of Trade"), in the opposing brief ("Resp. Br.") that it filed herein on November 1, 1982.

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[1] Pursuant to Rule 28.1 of the Rules of this Court, CBOE and OCC state that they have no parent companies, subsidiaries (other than wholly owned subsidiaries) or affiliates.

1. All parties in this proceeding and in the related proceeding (No. 82-526) filed herein by the Solicitor General on behalf of the Securities and Exchange Commission ("SEC") agree that these cases are moot.[2] Thus, the only question remaining is how the petitions for writ of certiorari should be handled. The SEC, CBOE and OCC have urged the Court to follow its "established practice" by granting the petitions, vacating the judgments of the court of appeals and remanding the cases with directions to dismiss the petitions for review as moot. *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39 (1950). The Board of Trade, however, has asked the Court to create an exception to the *Munsingwear* procedure and to deny the petitions for writ of certiorari. (Resp. Br. 6-11).

2. The Court in *Munsingwear,* 340 U.S. at 41, explained that the reason for vacating a lower court's judgment when a case has become moot is to prevent the judgment, "unreviewable because of mootness, from spawning any legal consequences." The Board of Trade asserts that that reason does not apply here because (1) it "does not intend to pursue the related cases filed in the Seventh Circuit"[3] and (2) "no issues determined by the court of appeals

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[2] *See* Memorandum for the Securities and Exchange Commission Suggesting Mootness filed in No. 82-526 on October 18, 1982; Memorandum of the Chicago Board Options Exchange, Incorporated and The Options Clearing Corporation Suggesting Mootness filed herein on November 1, 1982; and Resp. Br. at 6-7.

[3] There are two related cases pending in the Seventh Circuit. One (No. 82-1097) was instituted by the Board of Trade and the Chicago Mercantile Exchange to review an SEC order which had approved rules of CBOE and the American Stock Exchange ("AMEX") proposing trading on those exchanges of options on securities issued by the United States Department of the Treasury ("Treasury options"). The other (No. 82-2659) was instituted by the Board of Trade to review SEC orders which had approved rules of CBOE, OCC and AMEX relating to Treasury options and options on securities guaranteed by the Government National Mortgage Association ("GNMA options"). The rules relating to GNMA options at issue in No. 82-2659 are essentially the same as the rules at issue in the two cases that are the subject of the petitions for writ of certiorari.

are likely to affect either the Board of Trade or the petitioners." (Resp. Br. 9). These assertions, however, are simply not supportable. As discussed below, the legal consequences spawned by the judgments of the court of appeals could adversely affect CBOE and OCC.

First, the Board of Trade has refused to rule out the possibility that it may continue to litigate related issues against CBOE and OCC. On November 1, 1982, the Board of Trade filed motions to dismiss "without prejudice" the petitions for review in the two cases still pending in the Seventh Circuit. CBOE, AMEX and OCC filed a response in No. 82-2659 requesting that the petition for review therein be dismissed with prejudice. In its reply dated November 8, 1982, the Board of Trade opposed a dismissal with prejudice because it refused "to be estopped to argue that the current trading [of Treasury options on CBOE and AMEX] is illegal in some as yet unforeseen proceeding." Thus, since the related litigation between the Board of Trade, on the one hand, and the SEC, CBOE and OCC, on the other, may not yet be over, it is important to CBOE and OCC that their petition for certiorari be granted and the judgments below vacated so that the Board of Trade cannot argue in related litigation that those judgments have some collateral estoppel or res judicata effect against the SEC, CBOE and OCC.

More importantly, the judgments below should be vacated in order to prevent participants in the securities options market from claiming that the SEC, CBOE and OCC are estopped from relitigating the issues decided adversely to them. Among other things, the Seventh Circuit held (Pet. App. A-37 to A-45)[4] that exchange-traded securities options were not "securities" as then defined in Section 3(a)(10) of the Securities Exchange Act of 1934

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[4] "Pet. App." refers to appendix to the petition for a writ of certiorari filed herein by CBOE and OCC on August 25, 1982.

(the "Exchange Act"), 15 U.S.C. § 78c(a)(10) (1976).[5] As discussed in the petition for a writ of certiorari filed herein at pp. 13-17, this holding, if allowed to stand, would severely disrupt the established regulatory scheme pertaining to securities options. Although the recent enactment of Pub. L. No. 97-303 has alleviated this problem prospectively, the problem still exists with respect to prior actions taken under rules that were adopted on the understanding that exchange-traded options were "securities" under the Exchange Act prior to the enactment of Pub. L. No. 97-303.

For example, Regulation T of the Board of Governors of the Federal Reserve System ("Board")[6] was promulgated pursuant to the authority granted to the Board under Section 7 of the Exchange Act, 15 U.S.C. § 78g, to adopt regulations pertaining to credit extended *on securities*. Thus, a broker-dealer charged with violating the options provisions of Regulation T prior to the enactment of Pub. L. No. 97-303 could assert as a defense that the Board lacked statutory authority to establish margin requirements for options on the basis of the holding below that options were not securities. Indeed, if the SEC or CBOE were to bring a disciplinary action against the broker-dealer for violating Regulation T,[7] the broker-dealer could argue that they were estopped, under the doctrine of collateral estoppel,[8] from relitigating the

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[5] The recent enactment of Pub. L. No. 97-303, 96 Stat. 1409, has clarified the definition of "security" so that it now includes explicitly "any put, call, straddle, option, or privilege on any security." The text of Pub. L. No. 97-303 is reprinted in the appendix to the Memorandum for the Securities and Exchange Commission Suggesting Mootness filed by the Solicitor General in No. 82-526 on October 18, 1982.

[6] Among other things, Regulation T establishes margin requirements for broker-dealers with respect to options positions held in a customer's margin account. 12 C.F.R. § 220.3(i).

[7] The SEC is responsible for enforcing compliance with the rules and regulations adopted under the Exchange Act (including Regulation T) under Section 21 of the Exchange Act, 15 U.S.C. § 78u. CBOE has a statutory duty to enforce compliance by its members with such rules and regulations under Section 19(g) of the Exchange Act, 15 U.S.C. § 78s(g).

[8] *See Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 326-33 (1979).

issue of whether an exchange-traded option fell within the pre-Pub. L. No. 97-303 definition of "security." The need to prevent such legal consequences from being spawned is a compelling reason to follow the *Munsingwear* procedure in this case.

3. The Board of Trade argues that the petitions for certiorari should be denied because the parties had a "full and fair opportunity" to litigate the issues in the Seventh Circuit and that court (the Board of Trade contends) correctly decided those issues. (Resp. Br. 6-19). Although CBOE and OCC dispute the correctness of the Seventh Circuit decisions, no purpose would be served by having this Court consider the merits of a case that everyone agrees is now moot. The Board of Trade cites no authority for the proposition that this Court has recognized an exception to the *Munsingwear* procedure in cases where the parties have had a "full and fair opportunity" to litigate in the court of appeals. To the contrary, the Court has expressly followed the *Munsingwear* procedure in numerous cases where there had been a full adjudication of the issues in the court of appeals.[9] Similarly, the Board of Trade's attempt to distinguish this case from cases that became moot after certiorari had been granted (Resp. Br. 8-9 n.13) finds no support in this Court's decisions, while there are many examples of cases in which the Court followed the *Munsingwear* procedure when the mooting event occurred before the Court's decision on certiorari.[10]

The Board of Trade also seeks to create an exception to the *Munsingwear* procedure for this case because the mooting event occurred "through deliberate legislative and subsequent regulatory actions prompted by the petitioners themselves." (Resp. Br. 9). Although it is true that the SEC, CBOE and OCC supported the legislation that became Pub. L. No. 97-303, so also did the

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[9] *See, e.g., County of Los Angeles* v. *Davis*, 440 U.S. 625 (1979); *Weinstein* v. *Bradford*, 423 U.S. 147 (1975); *Preiser* v. *Newkirk*, 422 U.S. 395 (1975).

[10] *See, e.g., Alabama* v. *Davis*, 446 U.S. 903 (1980); *Connecticut State Board of Parole* v. *Bey*, 404 U.S. 879 (1971); *Cozart* v. *Wilson*, 352 U.S. 884 (1956); *SEC* v. *Harrison*, 340 U.S. 908 (1951).

Commodity Futures Trading Commission ("CFTC"), the securities industry and the commodities industry.[11] In its report recommending enactment of the legislation, the House Committee on Energy and Commerce expressed its view that the decision below by the Seventh Circuit was in error,[12] and the floor leaders of the legislation in both the House and Senate debates stated that the legislation was intended to overturn the Seventh Circuit decision.[13] Thus, the circumstances surrounding the enactment of Pub. L. No. 97-303 do not support the creation of an exception to the *Munsingwear* procedure; to the contrary, they underscore the need to vacate the judgments below, which Congress expressly determined to overturn.

Respectfully submitted,

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[11] *See* H.R. Rep. No. 626, Part 2, 97th Cong., 2d Sess. 4 (1982) (noting that the jurisdictional accord between the SEC and the CFTC, part of which was enacted as Pub. L. No. 97-303, "has the support of both the futures industry and the securities industry, the Chairman [sic] of the CFTC and the SEC and of the Administration").

[12] The House Committee stated its belief that put and call options on securities were themselves securities and that the Seventh Circuit decision was "not consistent with long-standing Congressional intent ...." H.R. Rep. No. 626, Part 1, 97th Cong., 2d Sess. 3, 8 (1982).

[13] *See* 128 Cong. Rec. H7476-77 (daily ed. Sept. 23, 1982) (remarks of Representative Dingell, Chairman of the House Committee on Energy and Commerce); 128 Cong. Rec. S13112 (daily ed. Oct. 1, 1982) (remarks of Senator D'Amato, Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs).